FILED
FEB 23 1957
JOHN T. FEY, Clerk

Supreme Court of the United States

OCTOBER TERM, 1956

No. 790

In the Matter of:

LIBERTY BAKING CORPORATION,
Debtor.

LIBERTY BAKING CORPORATION,
Petitioner,

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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THE COURT PRESS, 130 Cedar Street, N. Y. C.

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of Liberty Baking Corporation prays that a writ of certiorari issue to review the order and decree of the United States Court of Appeals for the Second Circuit entered in the above cause on the 16th day of January, 1957, reversing an order of the District Court of the United States for the Southern District of New York dated December 19, 1955 (R. 116; Appellant's Appendix, p. 60a).

Opinions Below

The order of the District Court denied the application of the Securities and Exchange Commission (hereinafter designated as the Commission) for leave to intervene and dismiss a petition filed by Liberty Baking Corp., as debtor, (hereinafter designated as Liberty) for relief under Chapter XI, §322 of the Bankruptcy Act, 11 U. S. C. 722 (R. 116-120; Appellant's Appendix pp. 60a-63a).

The order of the United States Court of Appeals for the Second Circuit reversed the order of the District Court and directed that the petition of Liberty be dismissed unless Liberty's petition is amended to comply with the requirements of Chapter X of the Bankruptcy Act, 11 U. S. C. 501 et seq.

Jurisdiction

The judgment of the United States Court of Appeals was entered on January 16, 1957.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code (28 U. S. C. 1254).

Questions Presented

On July 6, 1955 Liberty filed a petition under Chapter XI, §322 of the Bankruptcy Act, 11 U. S. C. 722. This petition contained a plan of arrangement for the debenture holders (unsecured creditors) of Liberty (R. 95; Appellee's Appendix, p. 13). The plan was accepted by the Debenture Holders' Committee which had in its possession acceptances amount-

ing to approximately $1,000,000 of a total outstanding of approximately $1,600,000, or substantially more than necessary to effectuate an arrangement under Chapter XI (R. 99; Appellee's Appendix, p. 16).

In considering the problems arising in connection with the application of the Commission, the related proceedings of Liberty's wholly owned subsidiary, Bell Bakeries, Inc. (hereinafter designated as Bell) are important. On December 31, 1953, Bell filed a petition for an arrangement under Chapter XI, §322 of the Bankruptcy Act. Bell is an operating company owning bakeries in several states where it manufactures principally bread for distribution to the retail trade (R. 87; Appellant's Appendix, p. 50a; R. 88; Appellee's Appendix, p. 12). Liberty's sole asset is the Bell stock and its sole creditors are substantially its debenture holders (R. 117; Appellant's Appendix, p. 60a). Bell's plan of arrangement was confirmed on June 30, 1955 (R. 93; Appellant's Appendix, p. 54a). Bell's plan provided for the payment of the claims of trade creditors of Bell at 65% payable in instalments of 2½% on confirmation and 2½% quarter annually thereafter (R. 88; Appellant's Appendix, p. 50a). Thus, at the time of argument in the United States Court of Appeals (November 16, 1956) 15% had been paid to creditors of Bell plus the administration expenses and taxes of the proceeding (R. 75; Appellant's Appendix, p. 47a).

Notwithstanding the complete rehabilitation of the operating corporation (R. 118; Appellant's Appendix, p. 61a) and the dismissal of the Commission's application by the District Court, the United States Court of Appeals for the Second Circuit reversed the District Court.

The questions presented are:

1. Did the reversal by the United States Court of Appeals of the exercise of the District Court's discretion, transcend the allowable bounds in directing that the Chapter XI proceeding be dismissed, as enunciated by this Court in *General Stores Corporation* v. *Shlensky*, 350 U. S. 462 (1956)?

2. Was there a sufficient public interest in the Chapter XI proceeding to warrant an intervention by the Commission and a finding that the proceedings should have been brought under Chapter X?

3. Was the relief sought by Liberty available to it under Chapter XI and was its plan consistent with the provisions of that Chapter?

4. Do the needs of Liberty require a proceeding under Chapter X?

5. Would relief under Chapter X be denied Liberty under Section 146, subdivision (2) of the Bankruptcy Act, 11 U. S. C. 546, subdivision (2), because relief was adequate under Chapter XI?

Statement

The sole party that has appeared to move the dismissal of the Chapter XI proceeding has been the Commission. Not a single debenture holder has appeared in opposition. Moreover, the Debenture Holders' Committee, representing substantial interests, has taken a strong position in favor of the Chapter XI proceeding (R. 109; Appellee's Appendix, p. 23).

Eliminating duplicates, there are only 333 public holders of all types of securities. Included in this figure are only 198 public debenture holders whose holdings barely exceed $1,000,000 (R. 100; Appellant's Appendix, p. 57a). And this latter group includes the substantial holdings of the Debenture Holders' Committee which favors the Chapter XI proceeding.

The interests to be affected are substantially private and not public. Debts of Liberty consist of $1,602,420 of unsecured debenture bonds. Management holds approximately 35% of the debentures and 79% of the common stock. In reviewing these factors, the District Court found that the arrangement did not affect a substantial public interest; that the plan of arrangement adequately protects the interests involved; and, finally that it would be needless to require the parties to go through a Chapter X proceeding. (R. 118, 119; Appellant's Appendix p. 61a, p. 62a).

The United States Court of Appeals in reversing, indicated that the District Court overlooked the narrow scope of Chapter XI; that there was need for all the machinery of Chapter X while the District Court had held "a Chapter X proceeding would be needless and time-consuming as well as the cause of further expense to all parties." (R. 119; Appellant's Appendix p. 62a). The United States Court of Appeals held that the proposed arrangement was more than a simple composition and involved a public interest while the District Court held, after reviewing the arrangement, that "the debtor's financial structure is and will be relatively simple. . . . In view of all the above, it does not seem that the proposed arrangement affects a substantial public interest." (R. 119; Appellant's Appendix p. 62a).

Since the District Court's findings did not transcend the allowable bounds, the reversal by the United States Court of Appeals was erroneous.

Statutes Involved

Section 328 of the Bankruptcy Act, 11 U. S. C. 728, reads as follows:

> "The judge may, upon application of the Securities and Exchange Commission or any party in interest, and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other persons as the judge may direct, if he finds that the proceedings should have been brought under chapter X of this Act, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirements of chapter X for the filing of a debtor's petition or a creditors' petition under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition, and the payment of such additional fees as may be required to comply with section 132 of this Act, such amended petition or creditors' petition shall thereafter, for all purposes of chapter X of this Act, be deemed to have been originally filed under such chapter."

Section 141 of the Bankruptcy Act, 11 U. S. C. 541, reads as follows:

> "Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the require-

ments of this chapter and has been filed in good faith, or dismissing it if not so satisfied."

Section 146, subd. 2 of the Bankruptcy Act, 11 U. S. C. 546, subd. 2, reads as follows:

"Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith, if—

adequate relief would be obtainable by a debtor's petition under the provisions of chapter XI of this Act . . ."

Specifications of Error to Be Urged

The United States Court of Appeals for the Second Circuit erred, in that,

1. In reversing the District Court's discretion which did not transcend the allowable bounds by holding the proceeding to be properly in Chapter XI.

2. In reversing the District Court's holding that there was not a sufficient public interest to warrant an intervention by the Commission and a finding that the proceeding was properly in Chapter XI when there were only 333 public holders of securities of all types.

3. In finding that relief was inadequate under Chapter XI for Liberty, although in fact it is adequate, and, notwithstanding the provision of §146 subd. (2) of the Bankruptcy Act, 11 U. S. C. 546, subd. (2), which requires a finding that for a petition to be filed in good faith, that it be shown that relief under Chapter XI is inadequate.

4. In finding that the needs of Liberty require a petition under Chapter X when in fact the needs of Liberty according to the principles enunciated by this Court in *General Stores Corp.* v. *Shlensky,* 350 U. S. 462 (1956) indicate no necessity for a transfer of the proceeding to Chapter X.

REASONS FOR GRANTING WRIT

I

The decision of the United States Court of Appeals for the Second Circuit with respect to the propriety of allowing a proceeding to remain in Chapter XI as against a transfer to Chapter X is in substantial conflict with a decision of the United States Court of Appeals for the Sixth Circuit.

The United States Court of Appeals for the Second Circuit placed emphasis on the fact that the District Court's decision antedated the decision of the Supreme Court in *General Stores Corp.* v. *Shlensky,* 350 U. S. 462 (1956) (R. p. 382, n. 1). However, in a similar situation, *Securities and Exchange Commission* v. *The Wilcox-Gay Corporation, et al.,* 231 F. 2d 859 (1956) the United States Court of Appeals for the Sixth Circuit arrived at a contrary conclusion, holding on facts substantially similar to those at bar that the District Court had not abused its discretion. In the *Wilcox-Gay* case, supra, the District Court denied the application by the Commission to transfer the Chapter XI proceeding to Chapter X (133 F. Supp. 548, W. D. Mich., 1955).

The United States Court of Appeals for the Sixth Circuit, in a unanimous opinion affirmed this decision. (231 F. 2d 859, 1956). The court frankly stated that it had withheld its decision until the determination of the Supreme Court in the *General Stores* case, (231 F. 2d at 860), and then, analyzing the *General Stores* case, the court stated that the "discussion by Mr. Justice Douglas indicates that the District Court in the case applied appropriate considerations and was privileged to exercise—as in our judgment he did—sound discretion in this matter."

The Court of Appeals for the Sixth Circuit then proceeded to analyze the basis of this discretion and indicated that the District Court's disposition of the case was based upon the following factors among others: The plan was feasible; there was a reasonable likelihood of rehabilitation of the debtor; the stockholders' interest could only be beneficial in the event continued operations were profitable; existing management's continuation of the business was staunchly advocated by creditors; opportunity was open at all times for interested parties to call any irregularities to the attention of the court; the transfer to Chapter X might be prejudicial to the ultimate success of the proposed plan and was not necessary; there was no public interest as distinguished from public ownership, which required the intervention of the Commission; and, finally further investigation was unnecessary in view of the activities of the various interests, including a Creditors' Committee.

The Court of Appeals for the Sixth Circuit concluded its decision in the *Wilcox-Gay* case by indicating that the considerations which had actuated the

exercise of discretion by the District Court in allowing the proceeding to remain in Chapter XI were in harmony with the principles set forth by the Supreme Court in the *General Stores* case, supra. It observed that the Supreme Court had indicated that the lower courts had concluded that the *General Stores Corporation* needed "a more pervasive reorganization than was available under Chapter XI." However, there was nothing in the opinion of the Supreme Court in the *General Stores* case that would indicate that an application of the principles therein set forth would require reversal in the *Wilcox-Gay* case. On the contrary, the court continued, the exercise of the district court's discretion was within the allowable bounds as set forth by the Supreme Court in the *General Stores* case.

The striking similarity between the *Wilcox-Gay* case and the case at bar is evident. Factors were there indicated which negated the need for Chapter X. These factors present equally cogent reasons for a denial of the transfer of these proceedings. The District Court's findings in the case at bar show a striking parallel with the findings of the Court of Appeals for the Sixth Circuit:

> 1. Public ownership is not synonymous with public interest so as to "call for all of the safeguards of a Chapter X proceeding. . . ." (R. 117; Appellant's Appendix, p. 60a). At bar there are only 333 public holders of all types of securities (R. 100; Appellant's Appendix, p. 57a), compared with 7,000 in the *General Stores* case, and even 3,000 in the *Wilcox-Gay* case. In one of its own decisions, (*In re Transvision, Inc.*, 217

F. 2d 243 (1954)) (Certiorari denied, 348 U. S. 952 (1955)), the United States Court of Appeals for the Second Circuit held to the same effect. Lacking a public interest, there is no sound reason for intervention by the Commission.

2. The plan of arrangement is feasible. Liberty does not operate any business, but its subsidiary, Bell Bakeries, Inc., operates the bakeries whose profits are utilized to pay the indebtedness of the debenture holders of Liberty (R. 117; Appellant's Appendix, p. 60a). A plan of arrangement of the subsidiary was confirmed and found to be feasible. It follows that all that the debenture holders can possibly receive in income are the net profits resulting from the operations of Bell Bakeries, Inc., after the payment of the claims of the creditors of Bell.

a) The debtor's position as the sole stockholder of Bell Bakeries, Inc. was subordinate to "the substantial claims of Bell's trade and other creditors. . . ." (R. 69; Appellant's Appendix, p. 35a, Letter of Manufacturers Trust Company, indenture trustee).

3. The debenture holders strongly supported the plan of arrangement and sufficient acceptances had been filed with their committee for acceptance of the plan (R. 109; Appellee's Appendix, p. 23). No one but the Commission had opposed its confirmation.

4. Investigation was unnecessary in view of the activities of the Creditors' Committee of Bell Bakeries, Inc., and its investigation of the operations of the subsidiary and the activities of the

parent. The burden was upon the Commission to establish and prove irregularities or improprieties as would warrant an accounting. "Ephemeral suspicions" such as exist in the case at bar were held to be insufficient in the *Transvision* case, supra.

5. Finally, as in *Wilcox-Gay,* the District Court held that "to require the parties to go through a Chapter X proceeding would be needless and time-consuming as well as the cause of further expense to all parties." (R. 119; Appellant's Appendix, p. 62a).

Moreover, the Second Circuit's distinction between the case at bar and the *Wilcox-Gay* case (note 10 of its opinion) is based on a fallacious assumption: Since the debtor had been in Chapter X before its transfer to Chapter XI, it had some corrective treatment and Chapter XI, therefore, was available to it. The assumption overlooks the fact that no plan was presented in Chapter X and Chapter XI has no provision for an active trustee who has any powers similar to that of a trustee in Chapter X. The transfer, then, to Chapter XI, left the corporation without any of the functional activity of a trustee, and the comparison is a distinction without a difference.

Furthermore, the distinction between affecting the rights of trade or commercial creditors or debenture holders is similarly unsubstantial. Both categories are unsecured creditors and both can be equally affected in a Chapter XI proceeding (Bankruptcy Act §306(1), 11 U. S. C. 706 (1)). Nowhere in either Chapter X or Chapter XI is there provided preferential treatment for public unsecured creditors as

against private unsecured creditors. Indeed, the Supreme Court in the *General Stores* case discusses public and private interests on a parity, mentioning " 'the public and private interests concerned. . . .' " (350 U. S., at 465).

Thus, with the findings of the District Court being on all fours with that of the Sixth Circuit in the *Wilcox-Gay* case, a reversal by the Second Circuit results in a substantial conflict between the circuits.

II

The decision of the United States Court of Appeals for the Second Circuit is in substantial conflict with the decision of the Supreme Court in *General Stores Corp.* v. *Shlensky*, 350 U. S. 462 (1956).

A

Since the decision of the Supreme Court in the *General Stores* case, one of the vexing problems raised by the Commission in *Securities and Exchange Commission* v. *United States Realty and Improvement Co.*, 310 U. S. 434 (1940), and in all the cases subsequent to it, has been decided adversely to the Commission. The Commission has always taken the position in these cases that Chapter X alone affords relief for corporations whose securities are owned by the public while Chapter XI is available to debtors whose stock is closely held.

Thus, in the case at bar, the Commission in its motion to dismiss alleged that Chapter XI was not avail-

able for a corporation with publicly held securities (R. 51; Appellant's Appendix, p. 18a). The Supreme Court in the *General Stores* case, supra, at p. 466, rejected this argument:

> "The character of the debtor is not the controlling consideration in a choice between c. X and c. XI. Nor is the nature of the capital structure. It may well be that in most cases where the debtor's securities are publicly held c. X will afford the more appropriate remedy. But that is not necessarily so. A large company with publicly held securities may have as much need for a simple composition of unsecured debts as a smaller company. And there is no reason we can see why c. XI may not serve that end. The essential difference is not between the small and the large company but between the needs to be served."

The "needs to be served" required a conversion of outstanding debentures (which had to be met at fixed time intervals) to preferred stock (which could be met out of profits). Since the wholly-owned operating subsidiary had a plan confirmed, and since the subsidiary's profits are the sole source of income for the debtor's debenture holders, a plan providing for a conversion of debentures to preferred stock was feasible. How closely in line is this plan with the Supreme Court's holding in the *General Stores* case, supra, as to feasibility: "A feasible plan . . . might mean . . . a funding of unsecured debt and a realignment of debt and stock so as to give a balanced capital structure" (350 U. S. at 467, 468). This is exactly what the debtor's plan is proposing to accomplish.

The extent of the feasibility of a plan at this stage of the proceeding prior to confirmation, is not such feasibility as must be shown for confirmation of a plan. Thus, in *Wilcox-Gay* the United States Court of Appeals held (231 F. 2d at 861):

> "The present plans *appear* to be feasible and *may be reasonably anticipated* to result in the rehabilitation of these debtor corporations as profitable enterprises." (Italics ours.)

Moreover, feasibility of the operations of the wholly-owned subsidiary, Bell, and the sole source of income to Liberty, has been determined by the order of confirmation of the Bell plan (R. 126; Appellee's Appendix, p. 28).

B

No indication existed in *General Stores* that an accounting had been made by management for the misdeeds which caused the insolvency. In the instant case no indication exists that there were any misdeeds. However, the activities of the wholly owned subsidiary have been thoroughly examined and a plan of arrangement approved. Need for further examination was disapproved by the District Court, and the United States Court of Appeals for the Second Circuit failed to take this fact into consideration in appraising the necessity for transfer to Chapter X.

No consideration was given to new management's activities in determining whether such management was necessary. In *General Stores,* management, which had changed the operation of the business, engaged in the pledging of valuable assets, "and generally caused

the debacle," was still in the saddle. In the case at bar top executives became affiliated with Liberty shortly before the Bell proceeding was initiated. These executives built up the morale of the organization and improved management by their skill and industry to increase the volume of the business and profits. Their initiative and effort were responsible for the results accomplished in the Bell arrangement and will likewise be necessary to launch Liberty on its new arrangement (R. 102, 103; Appellee's Appendix, p. 18).

An erroneous appraisal was made by the United States Court of Appeals in assessing the sacrifice made by the debtor in having claims of the Krug interests subordinate substantial loans to the claims of the debenture holders. In discussing commodity trading losses, no consideration was given by the United States Court of Appeals to the profits resulting from loans made in previous years (R. 90; Appellant's Appendix, p. 50a). The United States Court of Appeals cites *Taylor* v. *Standard Gas & Electric Corp.*, 306 U. S. 307; *Pepper* v. *Litton*, 308 U. S. 295; *Consolidated Rock Co.* v. *DuBois*, 312 U. S. 510, 523-524, as authority for a possible subordination without consent of the claimants. But nowhere in any of the foregoing cases are the facts similar to those at bar.

Moreover, the United States Court of Appeals for the Second Circuit has itself held in two decisions, *In re Ultimate Corp.*, 207 F. 2d 427 (1953) and *In re Madeline, Inc.*, 164 F. 2d 419 (1950), that in the absence of fraud or unfair advantage, it is not wrongful for an officer or a director of a corporation to lend money to it, and that such claims will not be treated as capital contributions under these circumstances.

C

Great stress is placed by the United States Court of Apppeals on the "fair and equitable doctrine." In *General Stores,* supra, creditors were being offered 40% of their claims instead of 100% which would have constituted full priority as contended for by the United States Court of Appeals. Notwithstanding this plan of 40% and this presumptive denial of priority, the Supreme Court held that this factor was not the controlling consideration (350 U. S. at 467):

> "A question as to what is 'fair and equitable' between creditors and stockholders may eventually be reached in the reorganization."

Thus, the Supreme Court left such determination to negotiation between stockholders and creditors. And a reduction in the debt was not held to be a vital factor in the determination of the propriety of the chapters. Indeed, in *Wilcox-Gay,* we find the plan providing for a reduction of the claims of creditors to 50% of their face amount. And, even though in *In re Transvision Inc.,* 217 F. 2d 243 (1954) (2nd Cir.), certiorari denied, *S. E. C.* v. *Transvision Inc.,* 348 U. S. 952 (1955), the claims of creditors were not reduced, they were extended over a period of time, which for all purposes had to be an act affecting their prompt payment, and denying priority.

The assertion of the "fair and equitable" doctrine, therefore, in its application to the initial determination of the propriety of the chapters, where it plays only a secondary role, to a primary position in the determination to be made by the court in a Chapter X proceeding, was clearly erroneous.

D

Certain inaccuracies are claimed to exist in the letter sent by the debenture holders to the creditors (R. 390). The finding fails to take into consideratio nthat before the letter had been mailed, the court had sent a copy of the plan to all the debenture holders. The so-called inaccuracies consist mainly of details concerning the plan of arrangement, which were not elaborated upon, and, certainly, any inference of concealment of facts is not substantiated by the record.

The whole idea behind the Liberty plan was to give Bell five years within which to pay off its unsecured creditors (R. 118; Appellant's Appendix, p. 61a) and then not to burden it with payment of dividends, if the profits did not exceed $65,000.00 and working capital was less than $400,000.00 (R. 41; Appellant's Appendix, p. 11a). However, if the debtor defaulted in the payment of twelve quarter-annual dividends, then the preferred stock would have the right to elect four of the seven directors (R. 42; Appellant's Appendix, p. 12a). The penalty, therefore, of failure to pay dividends, was loss of control.

Even in *Consolidated Rock Products* v. *Du Bois,* 312 U. S. 510, 529 (1941), the Supreme Court indicated an appreciation of the fact that hard and fast rules often resulted in injustices, and that concerning the problem of capitalization of past earnings, "Practical adjustments rather than a rigid formula, are necessary. The method of affecting full compensation for future interests will vary from case to case."

III

The decision of the United States Court of Appeals for the Second Circuit is in substantial conflict with the decision of its own court in *In re Transvision, Inc.*, 217 F. 2d 243 (1954), cert. denied, 348 U. S. 952 (1955).

In *In re Transvision Inc.*, 119 F. Supp. 134, (S. D. N. Y. 1953), aff'd, 217 F. 2d 243 (2nd Cir., 1954), cert. den., 348 U. S. 952 (1955), the debtor had 385,000 shares of common stock outstanding, of which 250,000 were owned by management and 135,000 by 425 public investors. The preferred stock was all owned by management. The stock had been sold at $2.75 per share to the public. Assets were valued at $998,041 and liabilities were $633,817.

It is noteworthy that in the *Transvision* case, the public interests were significantly more substantial than at bar. The Commission had not shown that irregularities existed. In affirming the court below the United States Court of Appeals, Second Circuit, far from decrying the inadequacy of Chapter XI as a procedure designed to sacrifice efficiency and safeguards in exchange for speed and economy of operations, stated (217 F. 2d at 246) that "the summary procedure provided by Chapter XI was designed to implement the successful invocation of relatively simple plans for affording debtors means by which, with a minimal disturbance of operations, to extricate themselves from current financial difficulty, without employing the elaborate investigatory and protective proce-

dures attendant upon the usual corporate reorganization under Chapter X."

The United States Court of Appeals also reiterated that the determination of the propriety of the chapters was in the sound discretion of the district court, and that the court had not abused its discretion in that case.

Moreover, in the *Transvision* case, the Court of Appeals for the Second Circuit emphasized the importance of considering the provisions of Sec. 130 subdivision (7) of the Bankruptcy Act, 11 U. S. C. 530, subdivision (7), and Sec. 146, subdivision (2) of the Bankruptcy Act, 11 U. S. C. 546 subdivision (2). Furthermore, in the case at bar the District Court cited these sections with the interpretation given them by the United States Court of Appeals for the Second Circuit (R. 119; Appellant's Appendix, p. 62a).

> "Indeed, the Bankruptcy Act itself, in requiring every petition under Chapter X to state 'Why adequate relief cannot be obtained under Chapter XI' Bankruptcy Act, Sec. 130 (7) 11 U. S. C. A. Sec. 530(7), and in declaring that 'A (Chapter X) petition shall be deemed not to be filed in good faith if . . . (2) adequate relief would be obtainable by a debtor's petition under the provisions of chapter II of this title', Bankruptcy Act Sec. 146, 11 U. S. C. A. Sec. 546, manifests a conscious purpose of Congress to encourage resort to Chapter XI whenever the remedy afforded thereby adequately protects the interests involved."

Indeed, two of the panel of judges, Chief Judge Clark, and the late Judge Frank, disagreed with the decision of the *Transvision* case, decided by an entirely different panel of judges. (*Shlensky* v. *General Stores Corp.*, 222 F. 2d at 236, 237).

CONCLUSION

The decision of the court below is, therefore, in conflict with decisions in the United States Court of Appeals for the Sixth Circuit, its own Circuit, and the Supreme Court of the United States. The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Opinion

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 67—October Term, 1956.

(Argued November 16, 1956 Decided January 16, 1957.)

Docket No. 24155

SECURITIES AND EXCHANGE COMMISSION

—v.—

LIBERTY BAKING CORPORATION

Before:

CLARK, *Chief Judge*, and
FRANK and HINCKS, *Circuit Judges*.

Appeal from an order, entered by Judge Noonan, of the United States District Court for the Southern District of New York. REVERSED.

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On July 6, 1955, Liberty Baking Corporation, appellee, filed a proceeding for an arrangement under Chapter XI of the Bankruptcy Act. The S. E. C. moved for leave to intervene and to dismiss the proceeding unless the petition were amended, or a creditors' petition were filed, in conformity with the provisions of Chapter X of that Act. On December 19, 1955, the district judge made an order denying this motion.[1] The S. E. C. has appealed.

Liberty, a Delaware holding company, has as its sole assets the stock of Bell Bakeries, Inc., and an open account against Bell. Before the institution of the proceedings for the reorganization of Liberty, Bell had filed a petition under Chapter XI.[2] Chapter XI arrangement for Bell was approved in June, 1955.

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[1] That order antedated the Supreme Court's decision in *General Stores Corp.* v. *Shlensky*, 350 U. S. 462.

[2] Bell's petition was filed December 31, 1953; Liberty's petition under Ch. XI was filed July 6, 1955.

The pertinent aspects of Bell's now confirmed reorganization are as follows:

The reorganization left undisturbed claims of secured creditors and of certain mortgage-holders apparently aggregating about $457,728.29. Creditors were divided into three classes. Class A creditors (general creditors with claims under $100) were to be paid 65% of their claims upon confirmation. Class B creditors (unsecured trade creditors other than management) were to be paid 2½% on confirmation, 42½% in seventeen annual quarterly installments commencing three months after confirmation, and 20% three months after the due date of the last installment; Class B creditors were thus to be paid a total of 65% of their claims over a four and one-half year period, unless debtor exercises its option to pay 45% within 6 months of confirmation thereby discharging these debts at the lower percentage. Class C creditors were subordinated to Class A and Class B. creditors; Class C represented management claims[2a] for loans to cover losses in commodity trading in the amount of $464,594; these claims were to be paid out over a four and one-half year period after the general trade creditors (Class A and B creditors whose claims amounted to $685,672) had been paid their 65%. At the time, management interests (hereinafter called Krug) agreed, in contemplation of a reorganization of Liberty, to a further subordination of these claims to those of Liberty's debenture holders; that is, in

[2a] Class C creditors were divided into two groups. Class C 2, the management interest were to be subordinate to a Class C 1 claim of about $600,000 which was to the Manufacturer's Trust Co., trustee in bankruptcy.

a reorganization of Liberty, management would accept common stock of that corporation in return for their claim against Bell.

Interest had been paid on Liberty's debentures from 1948, the time of their issuance, until 1953. The payment was made directly from Bell to the Indenture Trustee for Liberty's debenture holders, pursuant to an agreement between Bell and Liberty. After default of interest on the debenture's on January 1, 1954, an attempt was made to secure postponement of interest for a year, but insufficient consents were received.[3] Liberty's petition under Chapter XI was then filed on July 6, 1955, based on the default in interest.

As of July, 1955, the combined balance sheet of Liberty and Bell showed assets of $3,069,783. Bell's corporate liabilities amounted to $1,770,696. Added to Liberty's debentures in the amount of $1,602,420, the consolidated liabilities of the two corporations amounted to $3,373,000 exclusive of unpaid interest on the debentures.[3a]

In 1935, Liberty underwent a reorganization pursuant to former Section 77B of the Bankruptcy Act. In 1947, in order to eliminate large arrearages on its preferred stock, a voluntary recapitalization was made. Since then, the earnings of Bell, from which Liberty derived all its income, have been sporadic. Net income

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[3] Under the indenture, consent of 75% of the debentures, exclusive of management held or controlled debentures, is required for postponement of interest payments. Only 66% of the publicly held debentures consented.

[3a] The balance sheet of January 1955 and earlier balance sheets, which were filed with the petition for Chapter XI arrangement, showed balances less favorable to the debtor.

for the two companies on a consolidated basis since 1946 has been as follows:

1946—$314,168 profit
1947—$181,764 profit
1948—$ 96,902 profit
1949—$163,716 loss
1950—$ 56,498 profit
1951—$ 53,658 profit
1952—$ 57,030 loss
1953—$651,680 loss
1954—$ 50,375 loss
1955—(first half) $11,000 profit.[3b]

Liberty has outstanding: (1) 4% debentures due in 1978, in the principal amount of $1,602,420, of which $1,031,820 are in the hands of 198 public investors;[4] (2) 791 shares of $4.00 preferred stock, with a liquidating preference of $23,700, which are held by 27 public investors; (3) 43,064 7/20 shares of no par common stock at a stated value of $65,000, of which $13,000 are held by 160 public holders. In all, eliminating duplicate holders, there are 333 public investors in 20 states, holding over $1,000,000 in securities of Liberty. The common stock, 80% of which is held by management has exclusive voting rights.

Under the proposed Liberty plan, the existing pre-

[3b] Mr. Krug's affidavit in support of the motion to dismiss S. E. C. intervention states a profit to be $11,834.71 as of August 6, 1955 (Liberty's Appendix 59a). The unsworn balance sheet submitted by debtor shows a net profit for the same period of $12,286.62.

[4] In connection with the issue of these debentures in 1947, a registration stratement was filed with the S. E. C. pursuant to the Securities Act of 1933 and the Trust Indenture Act of 1939.

ferred shareholders (all public investors) would exchange one share of present preferred stock for one share of new preferred stock. The debenture holders (most of whom are public investors) would receive, for each $60 face value debentures held, new ($1.00 par value) preferred stock with a liquidation value of $50.00. The preferred stock is to be entitled to dividends of $2.50 annually, but the stock will be noncumulative until after the fifth year following confirmation. Before any dividends must be paid on the new preferred stock, the trade creditors of Bell must be paid off, and the Liberty must earn at least a net profit of $65,000 in the year in which the dividends are declared, as another condition precedent to payment of dividends on the new Liberty preferred stock, the working capital for that year must be $400,000.

Until five successive annual dividends are paid, the new preferred stockholders (mostly former debenture holders) may name three out of seven members of the board of directors. After five years, in the event the debtor defaults in payment of 12 quarterly dividends, the preferred will be permitted to elect four of the seven directors; this means that, for the first eight years, regardless of the outcome of the reorganization, the common stockholders (80% management) will control Liberty and that the debenture holders (almost all non-management) will have only a minority of the total votes.[4a]

[4a] 1. It is possible that the present debenture holders (who would be preferred stockholders under the proposed plan) could obtain control earlier. The default provision of the plan provides that the present debenture holders could elect all 7 directors if any default occurs under the plan of arrangement.

2. Since management owns about ⅓ of the debentures, it is

The letter sent out by the Debenture Holders Protective Committee (formed at a meeting called by management), to secure acceptance by the debenture holders of the proposed arrangement, failed to point out that there was a restriction on payment of dividends. It further failed to indicate that the debenture holders would not control if there were default in the payment of dividends, but to the contrary advised them that if there should be a default of three annual dividends they would elect the entire board of directors (as opposed to having to wait eight years and then electing four out of seven directors). The letter also stated that the Chapter XI proceedings disposed of the claims against Bell, and that Bell's "creditors" had agreed to settle for 65% of their claims, without indicating that Bell's creditors with claims of about $1,000,000 were not affected.

FRANK, *Circuit Judge:*

We take as our guide *General Stores Corporation* v. *Sklensky,* 350 U. S., 462, where the Court affirmed this court's decision which, in turn, affirmed a district court order granting a motion like that made by the S. E. C. in the instant case. The Supreme Court said, "It may well be that in most cases where the debtor's securities are publicly held, Chapter X will afford the more appropriate remedy." However, the Court said that

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possible that even after 8 years the present management interest could maintain control since they might succeed in having elected as the fourth director someone who would represent their own interests.

the fact that the debtor is a "large" corporation with a considerable amount of publicly held securities will not alone require dismissal of a Chapter XI proceeding with reference to "a simple composition of unsecured creditors." The Court noted instances where a Chapter X proceeding must be employed, for the reason that it requires (1) appointment of a disinterested trustee with "broad powers of investigation," (2) the S. E. C. to render an advisory report on the plan, and (3) a plan which is "fair and equitable" as well as "feasible." The instances the Court noted are: (a) "Readjustment of all or part of the debts of an insolvent company without sacrifice by the stockholders may violate the fundamental principle of a fair and equitable plan." (Citing *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106). (b) The "need for new management," since "without a new management today's readjustment may be a temporary moratorium before a major collapse." The controls required by Chapter X, said the Court, are "essential both where a complicated debt structure must be readjusted and where a sound discretion indicates either that there must be an accounting from the management or that a new management is necessary." The Court added that "these conditions only illustrate the need for Chapter X. There may be others equally compelling." The Court emphasized the importance of considering the General Store plan's feasibility, saying that, if the new proposed company were to succeed, "it may well need a more thorough going capital readjustment than is possible under Chapter XI." In the light of General Stores, we think the

Chapter XI proceedings must be dismissed, for the following reasons:

The proposed arrangement is for more than a "simple composition" of creditors. Not only are a considerable amount of Liberty's debentures held by public investors, but the arrangement would seriously disturb their rights. For, absent the Chapter XI arrangement, the debenture holders would be able to obtain control of management, since the common stock of Liberty is worthless. The arrangement would compel the debenture holders to accept, for their claims, preferred stock which would not only limit their share of the earnings and their share of the assets on liquidation, but which would deprive them of management control for at least 8 years. During those years, the old management, holder of all but a portion of the present common stock,—all of which is now junior to the debentures—would have control of management, despite the fact that, as shown by the earnings, it has, over the years, been far from successful in running Liberty and Bell.

As a *quid pro quo,* the old management would subordinate its claim against Bell to the new preferred to be received by the debentures. Perhaps, although we do not so decide, it might be true that, were this claim beyond question, such a subordination would be a sufficient "sacrifice" to justify the very substantial modification of the debentures' rights. But the manner in which the management's claim against Bell arose leaves considerable doubt whether that claim should not be ranked as junior to the Liberty debentures. It would be so ranked if, on investigation, it appeared that Bell's financial difficulties, which

occasioned the management's loans to it, resulted from the initial insufficiency of its equity capital, for then the loans would be regarded as if they had taken the form of contributions to capital. *Taylor* v. *Standard Gas & Electric Corp.*, 306 U. S. 307; *cf. Pepper* v. *Litton*, 308 U. S. 295; *Consolidated Rock Co.* v. *DuBois*, 312 U. S. 510, 523-524. Such an investigation, adequately conducted, calls for Chapter X treatment.

There is here, then, a grave question whether the plan would deprive creditors of their "absolute priority" rights as against stockholders (*Northern Pac. R. Co.* v. *Boyd*, 228 U. S. 482; *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106), a kind of question not nearly as obviously present in General Stores. Accordingly here the need for resort to Chapter X is must greater than was the need in General Stores.[4b]

In addition we have here factors which, if explored and disclosed by an independent trustee, might well lead to a determination by the publicly held debentures that a change of management is essential:[5]

[4b] The debtor makes much of the amendment of Chapter XI eliminating the requirement that a plan of arrangement be "fair and equitable." We might assume, *arguendo*, that, if a plan is properly within Chapter XI, it need no longer measure up to that standard or to anything equivalent. Even so, in determining whether a proceeding properly comes within that Chapter, it is necessary of course, to determine, among other things, whether the proposed arrangement contains features which bring it within Chapter X where the "fair-and-equitable" standard is applicable and where alone the facts relevant thereto will be fully investigated.

[5] Section 172 of Chapter X (11 U. S. C. S. 572) requires the judge to submit a proposed reorganization plan to S. E. C. for examination and report where the scheduled indebtedness exceeds $3,000.000. The consolidated liabilities of Liberty and Bell exceed that figure.

Over a period of 21 years, Liberty and Bell have experienced financial difficulties that have led to two proceedings under the Bankruptcy Act and a voluntary recapitalization.[6] There should be an adequate explanation of the consolidated loss of $651,680 in 1953.[7] The facts now of record suggest the possibility that an independent trustee's investigation might also reveal a need for "an accounting by the management for misdeeds" which caused the present necessity of a further reorganization.[8] The debenture holders cannot competently appraise the proposed plan without the educated advice of such a disinterested person. What an independent trustee's examination might disclose to those holders should be contrasted with the inaccurate and misleading letter which the Debenture Holders Protective Committee sent them, recommending acceptance of the proposed plan as the "best possible in the present circumstances." In the light of Liberty's troubled past,—its "chain of difficulties"

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[6] In *General Stores* v. *Shlensky*, 350 U. S. at 467, the Court said: "The history of the debtor indicates not fraud but an improvident over-extension or a business that has been out of step with modern trends. One corporate reorganization has already been suffered."

[7] The sole accounting, of record, for the 1953 loss was that made by Liberty's president as follows: "Duri. g this year management decided that it was necessary to change the brand name under which the Bell bread was being sold from Bell to Dandee. As a result of the advertising, promotion and selling and the fact that the transition could not be effective simultaneously at all plants, a good deal of sales volume was lost. In addition, management deemed it advisable at that time to decrease cake sales and to concentrate on the volume of bread sales because of the higher gross profits obtainable. This resulted in substantially the losses incurred that year."

[8] Cf. *General Stores*, 350 U. S. at 460.

—there is pertinent here, re feasibility, the following statement of the Supreme Court, in *Consolidated Rock Products* v. *DeBois,* 312 U. S. 510, 525: "Whether or not the earnings may reasonably be expected to meet the interest and dividend requirements of the new securities is a *sine qua non* to a determination of the integrity and practicability of the new capital structure."

Thus we have, in the instant case, important features which call for the application of Chapter X. Conceivably, under Chapter XI proceedings, a plan of arrangement might be presented which would unmistakably satisfy the requirements of Chapter X and would be as favorable to the creditors as what they could obtain under Chapter X. In such exceptional circumstances, we might not disturb the arrangement merely because it had been reached by Chapter XI proceedings. But that is not the case here. And since we conclude that Chapter X proceedings are the only appropriate means of dealing with reorganization of this debtor, we regard it as imperative that the case be remanded and a full investigation made—available in Chapter X only—to determine whether the plan is fair and equitable as well as feasible.

The debtor argues that, in General Stores, the Supreme Court referred to the district court's discretion.[9] But nowhere did the Court intimate that

[9] In fact, the Court referred to the exercise of discretion by "the two lower courts," i. e., the district court and the court of appeals.

this discretion would not be reviewable in circumstances like those here. We think that the district judge overlooked the very narrow scope of Chapter XI.[10]

Reversed.

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[10] In *S. E. C.* v. *Wilcox-Gay Corp.*, 231 F. 2d 859 (C. A. 6), it is true that the court, referring to the Supreme Court's decision in General Stores, upheld the exercise of the District Court's discretion to permit Chapter XI proceedings. But there the facts were considerably different from those in the instant case: (1) The debtor had previously undergone Chapter X proceedings, and, following rather extensive investigation of its affairs in those proceedings, was permitted to go into Chapter XI proceedings after the secured creditors' claims were met in full. (2) The debenture holders (who held securities of about $220,000) received interest payments on their claims, and apparently only general (trade) creditors were included in the scaling down to 50% of their claims. (3) The court rested its decision on the ground that the analytical procedures available under Chapter X had in fact been carried out by the Trustee in the preceding Chapter X proceedings; the court was convinced that there was no need for further independent investigation; and no possible benefit could accrue to the general public, general creditors, or secured creditors by further investigation. Here, on the other hand, we have no such assurance or conviction. (4) Finally, in the Wilcox-Gay case, the debtor corporations were wholly owned by the creditors of the corporations, and the "outstanding securities of the debtor corporations have no book value." There has been no testimony to the effect that the securities of the corporations in this case are without book value, and certainly the proposed arrangement here does not contemplate putting the control of the company in the hands of creditors, as did the arrangement in the Wilcox case.

In re Transvision, Inc., 217 F. 2d 243 (C. A. 2), certiorari denied *S. E. C.* v. *Transvision, Inc.*, 348 U. S. 952, involved no disturbance of the creditors' priority rights, and the plan affected trade and commercial creditors only. More important, that decision antedated the Supreme Court's decision in General Stores.

Judgment

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the sixteenth day of January one thousand nine hundred and fifty-seven.

Present:

HON. CHARLES E. CLARK,
Chief Judge,
HON. JEROME N. FRANK,
HON. CARROLL C. HINCKS,
Circuit Judges.

In the Matter of LIBERTY BAKING CORPORATION
Debtor

v.

SECURITIES & EXCHANGE COMMISSION
Appellant

Appeal from the United States District Court for the Southern District of New York

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed.

A. DANIEL FUSARO
Clerk

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CITATIONS

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Section 328 (11 U. S. C. 728) — 2

420864—57

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 790

LIBERTY BAKING CORPORATION, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (Pet. 23–35) has not yet been officially reported. The opinion of the District Court is not reported. It is set forth in the appendix, *infra*, at pages 11–14.

JURISDICTION

The judgment of the Court of Appeals (Pet. 36) was entered on January 16, 1957. The petition for a writ of certiorari was filed on February 23, 1957. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTION PRESENTED

Whether it was error for a district court to permit a debtor with publicly held unsecured debentures to

utilize the arrangement procedures of Chapter XI of the Bankruptcy Act, rather than the reorganization procedures of Chapter X, where the proposed arrangement affected the debenture holders and thus raised questions whether they would receive fair and equitable treatment and where Chapter XI would otherwise fail to meet important needs.

STATUTE INVOLVED

Chapters X and XI of the Bankruptcy Act, 52 Stat. 883 and 905, 66 Stat. 432 (11 U. S. C. 501 *et seq.* and 701 *et seq.*), are involved in this proceeding substantially in their entirety. Section 328, which is directly involved, is set forth at page 6 of the petition.

STATEMENT

The court below reversed an order of the United States District Court for the Southern District of New York, dated December 19, 1955 (App. 60–63a),[1] denying a motion by the Securities and Exchange Commission to dismiss the proceeding brought by Liberty Baking Corporation for an arrangement under Chapter XI of the Bankruptcy Act unless the petition be amended, or a creditors' petition be filed conforming to the provisions of Chapter X of the Act (App. 22a).

Liberty Baking Corporation ("Liberty"), the debtor herein, is a holding company, which has as its sole substantial assets the capital stock of Bell Bakeries, Inc. ("Bell") (App. 25a), and a small open ac-

[1] "App." refers to the Securities and Exchange Commission appendix in the court below. "App. B" refers to Liberty Baking Corporation appendix in the court below.

count against Bell. As of July 6, 1955, when Liberty filed its petition under Chapter XI of the Bankruptcy Act, it carried the Bell stock on its books at $1,743,-135 (App. B 15a–16a). Liberty has 333 public investors (eliminating duplicate holders), located in 20 states, holding over $1,000,000 in securities. The following securities are outstanding: (1) 4% debentures due in 1978 in the principal amount of $1,602,420, of which approximately $1,031,820 is in the hands of 198 public investors; (2) 791 shares of $4 preferred stock with an aggregate liquidating preference of $23,700, all of which is in the hands of 27 public investors; (3) 43,064⅞₀ shares of no par value common stock of a stated value of $65,000, of which approximately $13,-000 is in the hands of 160 public holders. The common stock, of which management holds approximately 80%, has exclusive voting rights. (App. 24a, 57a–58a.)

In 1935, Liberty underwent a reorganization under former Section 77B of the Bankruptcy Act (App. 25a). In 1947, in order to eliminate large arrearages on its preferred stock, a voluntary recapitalization was entered into (App. 25a, 26a, 54a). Since that date, the earnings of Bell, from which Liberty derives all of its income, have been sporadic. On a consolidated basis, losses were incurred in 1949, 1952, 1953, and 1954. In 1953, the consolidated loss was $651,-680 (App. 28a).

On December 31, 1953, Bell, the debtor's wholly owned subsidiary, filed a petition for an arrangement under Chapter XI of the Bankruptcy Act because of its inability to meet the obligations of its trade

creditors (App. 50a). The consolidated balance sheet of Liberty and Bell, prior to confirmation of the Bell plan of arrangement, showed assets of $3,237,731 and liabilities of $3,961,416 (App. 27a). The arrangement of Bell, confirmed on June 30, 1955, provided that unsecured trade creditors, whose claims amounted to $685,672, were to be paid 65% of their claims over a four and a half-year period, thereby obligating Bell to pay out $445,686 through quarterly installments of $18,260, with the balance to be paid in 1959 (App. 29a, 49a-51a).[2]

As of August 6, 1955, after the Bell arrangement had been confirmed, the consolidated assets were approximately $3,070,000 as against consolidated liabilities of $3,373,000, exclusive of more than two years unpaid interest on the debentures (App. 27a, 42a).

The proposed arrangement of Liberty contemplates a merger of Liberty and Bell. Principally, the arrangement provides that the outstanding debenture holders will receive one share of $1.00 par preferred stock for each $60 face value of debentures held. The preferred stock will carry a liquidation value of $50 and will be entitled to an annual dividend of $2.50 per share payable quarter-annually. However, the stock will be non-cumulative until after the fifth year after confirmation. Before dividends can be paid, it is provided that the trade creditors of Bell shall be

[2] Claims by management interests in the amount of $464,594 for advances to cover losses in commodity trading were agreed to be subordinated to the claims of other creditors of Bell and also, if the then contemplated Chapter XI proceeding of Liberty should be effected, to the claims of Liberty's debenture holders (App. 52a).

paid first; that the debtor must earn a net profit of at least $65,000 in the year that dividends are to be declared; and that the working capital must be equal to at least $400,000. Until five successive annual dividends are paid, the preferred stock will have the right to name 3 of the 7 members of the board of directors. Commencing five years after confirmation of the plan, in the event that the debtor defaults in the payment of 12 quarterly dividends, the preferred stock will be permitted to elect 4 of the 7 directors; and in the event of default under the Bell arrangement or in other specified contingencies, the preferred stock will be entitled to elect all of the directors. (App. 7a–16a.)

The proposed arrangement for Liberty further provides that the existing preferred shareholders will be permitted to exchange one share of old preferred stock for one share of the new $2.50 preferred ($1 par value) (App. 15a). The existing common stock, 80% of which is controlled by management, will continue to be the common stock of the remaining corporation, retaining its right to elect a majority of directors unless there are defaults as noted above (App. 12a–13a).

To secure acceptance of the proposed Liberty arrangement, a letter was sent to all the debenture holders enclosing a proof of debt and a form of acceptance (App. 39a–41a). As noted by the court below, this letter was misleading in various material respects (Pet. 29, 33).

ARGUMENT

In *General Stores Corp.* v. *Shlensky*, 350 U. S. 462, this Court considered the circumstances under which a cor-

poration with public security holders seeking rehabilitation under the Bankruptcy Act might utilize Chapter XI, rather than Chapter X, and we are aware of no reason why it should be necessary for this Court to reconsider at this time the questions answered in that case.

In holding that Chapter X was appropriate in the *General Stores* case, the Court reaffirmed its holding to the same effect in *Securities and Exchange Commission* v. *U. S. Realty Co.*, 310 U. S. 434. It spelled out the determinative criterion as "the needs to be served" and set forth "typical instances where c. X affords a more adequate remedy than c. XI." 350 U. S. at 466, 467.

The first of these typical instances was where "[r]e-adjustment of all or a part of the debts of an insolvent company without sacrifice by the stockholders may violate the fundamental principle of a fair and equitable plan" (*id.* p. 466). As the court below indicated (Pet. 31, 32), the proposed plan of arrangement in this case, which would cut down the interests of public debenture holders while permitting continued participation by the stockholders, clearly deprives the debenture holders of their right to "absolute priority" in the absence of a capital contribution by the stockholders. The court below did not pass upon whether the proposed subordination of a claim against Bell in favor of the management, which holds most of Liberty's common stock, would be "a sufficient 'sacrifice' to justify the very substantial modification of the debentures' rights," since the manner in which the claim arose raised "considerable doubt whether that claim should not be ranked as junior to the Liberty de-

bentures." An investigation under Chapter X, as the court noted, might show that the claim should be treated as a contribution to capital. Cf. *Taylor* v. *Standard Gas Co.*, 306 U. S. 307.

Other illustrations of the "needs to be served" set forth in *General Stores* relate to the necessity of determining whether the debtor should continue under its existing management and whether that management should be held accountable for the debtor's difficulties. 350 U. S. at 466. As indicated in both *General Stores*, 350 U. S. at 467, and the *U. S. Realty* case, 310 U. S. 449–451, Chapter X alone provides procedures for full examination of the debtor's past operations which would enable security holders to determine the necessity for new management as well as disclose possible causes of action in favor of the corporation. The court below pointed to factors here "which, if explored and disclosed by an independent trustee" under Chapter X might lead to a determination "that a change of management is essential" and to a possible accounting by the management (Pet. 32–33). As in the *General Stores* case, moreover, the debtor here has had a "chain of difficulties" going back over two decades, and, as in that case, a "paramount issue * * * concerns what is 'feasible'." (350 U. S. at 464 and 467) Only through Chapter X would the court be in a position to effectuate the complete reorganization that appears to be necessary in view of the past history of this enterprise, and only through that Chapter would the security holders have the complete and objective information necessary to enable them to determine whether to accept any plan or, indeed,

whether to choose liquidation of the enterprise. See the discussion in the *U. S. Realty* case, 310 U. S. at 448–453.

It is thus clear, contrary to petitioner's contention (pp. 13–17), that the determination of the court below is correct and is fully in accord with this Court's decision in the *General Stores* case.[3]

Nor does the decision below conflict with the determination of the Court of Appeals for the Sixth Circuit in *Securities and Exchange Commission* v. *Wilcox-Gay Corp.*, 231 F. 2d 859. In that case, the claims of public security holders were not scaled down. Petitioner contends (p. 12) that "the distinction between affecting the rights of trade or commercial creditors or debenture holders is * * * unsubstantial" and states: "Both categories are unsecured creditors and both can be equally affected in a Chapter XI proceeding * * *." We submit that both the *U. S. Realty* and *General Stores* cases make clear that the rights of public debenture holders can be affected only through a fair and equitable plan and that, where compliance with the absolute priority rule as to such creditors is in question, only Chapter X is appropriate.[4]

[3] As to petitioner's contention (p. 17) that the "fair and equitable doctrine" was not important in the *General Stores* case because this Court indicated that questions thereon "may eventually be reached in the reorganization," it should be noted, in addition to the emphasis placed on "the fundamental principle of a fair and equitable plan" (p. 6, *supra*), that the creditor claims which were to be reduced from 100% to 40% under the proposed Chapter XI plan in that case were not the claims of public security holders. See discussion in text, *infra*, and in footnote 4.

[4] The *General Stores* opinion pointed out (350 U. S. at 466) that in the *U. S. Realty* case the holders of the publicly owned

Moreover, as pointed out by the court below, the debtor in the *Wilcox-Gay* case had been in Chapter X proceedings; its affairs had been investigated by an independent trustee; and the Sixth Circuit decision rested "on the ground that the analytical procedures available under Chapter X had in fact been carried out by the Trustee in the preceding Chapter X proceedings" (Pet. 35).

In re Transvision, Inc., 217 F. 2d 243, with which petitioner also claims a conflict, did not involve the claims of any public creditors. In any event, that case was decided by the Court of Appeals for the Second Circuit prior to the *General Stores* case, and, indeed, the petition for a writ of certiorari in the latter case (Oct. Term, 1955, No. 170, p. 9) urged the "confusion" existing "among the panels of the Second Circuit," as evidenced by its decisions in *General Stores* and *Transvision*, as a reason for granting the writ; accordingly, to the extent that the *Transvision* case might be considered inconsistent with the instant

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mortgage certificates were "being asked to make sacrifices, while the position of the stockholders remained unimpaired * * *, contrary to the teachings of *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106." The *U. S. Realty* case had stated that the Chapter X safeguards in this context "would seem to be indispensable to a just determination whether the plan is fair and equitable." 310 U. S. at 453. By again citing the *U. S. Realty* case in the *General Stores* opinion and in noting that a situation where the existence of a threat of violation of the "fundamental principle of a fair and equitable plan" is a typical instance "where c. X affords a more adequate remedy than c. XI" (350 U. S. at 466), this Court clearly reaffirmed its determination in the *U. S. Realty* case that Chapter X alone is appropriate wherever there might be a question as to absolute priority for public debt security holders.

case, it was in effect overruled by this Court's decision in *General Stores*.

CONCLUSION

The judgment below is correct and presents no conflict or inconsistency with decisions of this Court or any other court. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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MARCH 1957.

APPENDIX

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

No. 91173

IN THE MATTER OF LIBERTY BAKING CORPORATION, DEBTOR

MEMORANDUM

Filed: U. S. District Court, S. D. of N. Y., Dec. 19, 1955

NOONAN, *D. J.*

The Securities and Exchange Commission has moved herein for leave to intervene and to (1) dismiss the Debtor's petition, (2) refuse confirmation of the Debtor's arrangement, and (3) to dismiss the proceeding unless the petition be amended, or a creditors' petition be filed, conforming to the provisions of Chapter X of the Bankruptcy Act.

In brief, this is another case wherein the Securities and Exchange Commission feels that there is a sufficient public interest to warrant the court setting aside all that has gone before in the proceedings already had pursuant to Chapter XI of the Bankruptcy Act.

The growing problem that this type of case raises for parties, the bar and the bench, is referred to in the October 1955 issue of the Journal of the National Association of Referees in Bankruptcy Vol. 29, p. 139.

The Transvision case (*in re Transvision, Inc.*, 119 F. Supp. 134, aff'd 217 F. 2d 243; cert. den'd 348 U. S.

952) is authority for the proposition that public ownership of a substantial portion of the stock is not, per se, proof of sufficient public interest to call for all of the safeguards of a Chapter X proceeding. The latter procedure is designed to protect unsecured creditors in general rather than stockholders alone.

Inevitably, by virtue of the wording of the Act itself, the determination of each case must rest on its own merits and on its own special state of facts with regard to the debtor's financial and debt structure.

In the instant case, the debtor has the following securities outstanding:

(1) 4% debentures due in 1978—$1,602,420 (of which 35% in value is in the hands of management, former and present);

(2) 791 shares of $4 preferred stock, all in the hands of 27 members of the public;

(3) 43,064 7/20 shares of no par common stock, of which 79% is held by management.

The debtor is a holding company and its sole asset is the entire capital stock of Bell Bakeries, Inc., which owns and operates bakeries in six states. Since Liberty is not in any separate business, its liabilities are generally limited to its debentures.

The latest annual consolidated balance sheet for the debtor and its wholly-owned subsidiary (dated January 1, 1955) lists the total assets at $3,237,731 and the total liabilities at $3,961,416, indicating a net capital deficiency of $723,685.

Although the debtor, through its subsidiary, has shown substantial losses over the past few years, its latest balance sheet shows a gain.

The subsidiary corporation filed a petition under Section 322 of the Bankruptcy Act and an arrangement was proposed and confirmed by the Court

whereby unsecured creditors are to be paid 65% in quarterly installments over a 4½ year period. In the Bell Baking Co. proceeding, trade creditors filed claims in the amount of $685,672, thus obligating the subsidiary (whose stock is the sole asset of the current debtor) to pay out almost $450,000 in regular installments over 4½ years.

The proposed arrangement herein contemplates a merger of the two corporations, and the issuance of $1 par preferred stock to holders of the debtor's outstanding debentures in the sum of $1,602,420 (at the rate of one share for each sixty dollars of debenture), which stock is to pay dividends of $2.50 a share, but remain limited to $50 per share in liquidation by lot, and to be temporarily non-cumulative so as to permit the subsidiary company's obligations to be met.

According to the facts and figures of this case, there are only 333 public holders, holding approximately 27,000 securities of all types; of this group only 198 are debenture holders.

The proposed arrangement provides that, after conversion of the debentures to preferred stock, the new preferred stockholders will elect 3 of the 7 directors. It further provides that, in the event of certain defaults in payment, these new preferred stockholders may elect the entire Board of Directors. The debentures came into being by a previous conversion from preferred stock; the arrangement under consideration would reconvert the debentures back into preferred stock. The debtor's financial structure is and will be relatively simple.

In view of all of the above, it does not seem that the proposed arrangement affects a substantial public interest.

In the *Transvision case* (*supra*), Judge Medina stated, at page 246:

> Indeed, the Bankruptcy Act itself, in requiring every petition under Chapter X to state "Why adequate relief cannot be obtained under Chapter XI" Bankruptcy Act, Sec. 130 (7), 11 U. S. C. A. Sec. 530 (7), and in declaring that "A (Chapter X) petition shall be deemed not to be filed in good faith if * * * (2) adequate relief would be obtainable by a debtor's petition under the provisions of chapter II of this title", Bankruptcy Act Sec. 146, 11 U. S. C. A. Sec. 546, manifests a conscious purpose of Congress to encourage resort to Chapter XI whenever the remedy afforded thereby adequately protects the interests involved.

It is the opinion of this court that the remedy afforded by the arrangement as worked out between management and the creditors' committee adequately protects the interests involved, and that to require the parties to go through a Chapter X proceeding would be needless and time-consuming, as well as the cause of further expense to all parties.

It is, therefore, the ruling of this court that the petition of the Securities and Exchange Commission for leave to intervene, and for certain other relief referred to in the beginning of this opinion, should be, and hereby is, denied.

So ordered.

Dated: New York, N. Y., December 19, 1955.

GREGORY F. NOONAN,
U. S. D. J.

U. S. GOVERNMENT PRINTING OFFICE: 1957